

No. 9857

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**In the United States Circuit Court of Appeals  
for the Ninth Circuit**

GEORGE J. SOMERVILLE, ALSO KNOWN AS SLIM SUM-  
MERVILLE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

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ON PETITION FOR REVIEW OF DECISION OF THE UNITED  
STATES BOARD OF TAX APPEALS

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**BRIEF FOR THE RESPONDENT**

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**OPINION BELOW**

The only previous opinion in this case is that of the United States Board of Tax Appeals promulgated March 14, 1941 (R. 12-23), which is reported at 43 B. T. A. 968.

**JURISDICTION**

This appeal involves federal income taxes for the calendar years 1936 and 1937, in the respective amounts of \$3,588.01 and \$11,229.22, and is taken from a decision of the United States Board of Tax Appeals entered March 14, 1941 (R. 24). The case is brought to this Court by a petition for review filed by the taxpayer on June 3, 1941 (R. 25-29), pursuant to the

provisions of Sections 1141–1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the income received by the petitioner, a resident of California, for personal services rendered during the period from the time he entered into a property-settlement agreement with his wife until she was granted a final decree of divorce is taxable in its entirety to the petitioner as his own income, or whether only one-half of the net income received by him during that period for personal services rendered is taxable to him.

STATUTES INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. \* \* \*

\* \* \* \* \*

Civil Code of California (1937):

SEC. 158. *Husband and wife may make contracts.*—Either husband or wife may enter into any engagement or transaction with the other,

or with any other person, respecting property, which either might if unmarried; subject, in transactions between themselves, to the general rules which control the actions of persons occupying the confidential relations with each other, as defined by the title on trusts.

SEC. 159. *Contract altering legal relations: Separation agreement.*—A husband and wife cannot, by any contract with each other, alter their legal relations, except as to property, and except that they may agree, in writing, to an immediate separation, and may make provision for the support of either of them and of their children during such separation.

SEC. 160. *Consideration for agreement of separation.*—The mutual consent of the parties is a sufficient consideration for such an agreement as is mentioned in the last section.

\* \* \* \* \*

SEC. 161a. *Interests in community property.*—The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172a of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in community property.

#### STATEMENT

This is an appeal from a decision of the United States Board of Tax Appeals (R. 24) sustaining a determination by the Commissioner of Internal Revenue of deficiencies in the federal income tax liability

of the petitioner for the calendar years 1936 and 1937 (R. 6-11).

The facts in this case were stipulated before the Board of Tax Appeals (R. 31-86), and the facts as stipulated were adopted by the Board as its findings of fact (R. 15).

The petitioner is an individual residing at Redondo Beach, California (R. 3, 11), and filed federal income tax returns for the years 1936 and 1937 (R. 72-85) with the Collector of Internal Revenue at Los Angeles, California.

The petitioner and Gertrude Martha Somerville were husband and wife for several years prior to 1936 (R. 34), and during the years 1936 and 1937 the petitioner was a resident of the State of California (R. 35).

On September 1, 1936, the petitioner and his wife entered into a property-settlement agreement (R. 34) which is set out in full in the record (pp. 41-71). On September 28, 1936, an interlocutory decree of divorce was entered in the Superior Court of the State of California, in and for the County of Los Angeles, in a proceeding instituted against the petitioner by his wife (R. 34, 37-39). On October 2, 1937, the same court entered a final decree of divorce in the same proceeding (R. 34, 39-40). The petitioner remarried on December 8, 1937 (R. 35).

During the year 1936 the petitioner received the net amount of \$61,440.46 as compensation for personal services rendered by him. Of this amount the sum of \$28,357.23 represented his net earnings for the period subsequent to the execution of the property-



settlement agreement by the petitioner and his wife on September 1, 1936. During the year 1937 the petitioner received the net amount of \$79,766.71 as compensation for personal services rendered. Of this amount the sum of \$57,833.70 represented his net earnings for the period from January 1, 1937, to and including October 1, 1937, before the final decree of divorce was entered in the proceeding instituted against him by his wife (R. 35-36).

In his federal income tax return for the year 1936 (R. 72-75) the petitioner reported as a part of his gross income the sum of \$30,720.23, being one-half of the net amount of \$61,440.46 received by him during the year as compensation for personal services rendered. The remaining one-half of the petitioner's net earnings in 1936 for personal services rendered was reported in the income tax return filed by his wife for the year 1936 (R. 35, 72).

In his federal income tax return for the year 1937 (R. 76-85) the petitioner reported as a part of his gross income the sum of \$47,860.97 as compensation for personal services rendered. This sum consisted of \$28,941.85, being one-half of his net income for the period from January 1, 1937, to October 2, 1937, for personal services rendered (R. 36, 79), his entire net income of \$15,955.23 for personal services rendered for the period from October 2, 1937, until his remarriage on December 8, 1937 (R. 36, 80), and \$2,963.89 representing one-half of his earnings for personal services for the period from his remarriage until the end of the taxable year (R. 36, 81). The sum of \$28,941.85, being one-half of the petitioner's personal earnings for

the period from January 1, 1937, to October 2, 1937, when his wife obtained the final decree of divorce, was reported in the 1937 income tax return of Gertrude Martha Somerville (R. 36).

In determining the income-tax deficiencies here in controversy (R. 6-11) the Commissioner of Internal Revenue added to the gross income reported by the petitioner for the years 1936 and 1937 the one-half of the net earnings received by him during the period from September 1, 1936, to October 2, 1937, for personal services rendered which had been reported in the income-tax returns of Gertrude Martha Somerville for those years. The Commissioner explained that his action in so treating the personal earnings of the petitioner for this period was due to the fact that under the property-settlement agreement entered into by the petitioner and his wife the earnings of the petitioner for this period became his separate property and therefore taxable entirely to him (R. 8-9, 10). The Commissioner's determination was sustained by the Board of Tax Appeals (R. 12-23).

In the property-settlement agreement (R. 41-71) entered into by the petitioner and his wife on September 1, 1936, it was stated that whereas unhappy differences had arisen between the parties which made it impossible for them to live together, and that since they must henceforth live separate and apart (R. 41-42)—

it is the desire and intent, finally and absolutely, of said parties, by this indenture, to settle and forever adjust, and have settled and forever adjusted between themselves, all of their

mutual and respective present and future property rights, both as to the properties which either may claim to be community property, and also as to the separate estate of each, and it is their desire and intent to settle and adjust, finally and absolutely, by this indenture, any and all claim or claims for alimony, separate maintenance, counsel or attorney's fees, or costs of Court in any action that may be brought for a divorce, or any action that may now be pending, between said parties, or in any action at law or other litigation, or otherwise, which either of the parties hereto may or might hereafter make one against the other \* \* \*

The agreement then provided at great length and in great detail for the disposition of a multitude of business and domestic problems, including the settlement of interests in money on hand and all property and assets owned by them individually or as community property. It also provided that, after the date of its execution, income-tax assessments "due, paid, or payable anywhere" upon the income of the wife "are to be borne and paid for solely by" the wife and not by the petitioner (R. 66). Any taxes which might become due upon the income of the parties prior to the execution of the agreement were to be borne by them equally (R. 67).

Among the material provisions of the property-settlement agreement were the following (the term "first party" being used to designate the wife and the term "second party" being used to designate the petitioner) (R. 42, 44, 49-50, 68-69):

Whereas it is further desired and agreed on the part of the parties hereto, finally and abso-

It is further mutually understood and agreed that each of the parties may for themselves, independently of the other, control or do business in all matters the same as though he or she were single.

It is further understood and agreed that in making this final settlement of property rights that each of the parties hereto waives, relinquishes and forever surrenders all claim or claims of every kind or nature which she or he has or might hereafter acquire in or to or against the property of the other now held or hereafter acquired, including the rights of inheritance in case of death intestate or testate, which right each hereby expressly waives in favor of the heirs of the other.

It is further mutually understood and agreed that each of the parties hereto, their respective heirs, executors, administrators or assigns, shall, at any and all times, execute any paper that may be necessary to be executed for the purpose of giving full force and effect to these presents and to the covenants, provisions and agreements herein contained.

\* \* \* \* \*

The agreement contained elaborate provisions for determining the amount of the petitioner's "net income" which was to be paid to the wife under the provisions set out above (R. 44-49). It also contained detailed provision for the use and distribution of the cash which petitioner had on hand on the date the agreement was executed (R. 53-57). These and other provisions of the agreement relating to the division of specific properties and the custody and support of their minor child are important in this proceeding

only because they demonstrate the completeness with which all their property and marital relations were settled.

#### SUMMARY OF ARGUMENT

The petitioner and his wife, due to marital difficulties, separated prior to September 1, 1936. On that date they entered into a property-settlement agreement which provided for division of all their property, settlement of all claims against each other, and custody and maintenance of their minor child. A final decree of divorce was granted to the petitioner's wife on October 2, 1937.

Under California law the personal earnings of a husband and wife become community property, and for the period here involved such income is taxable one-half to each spouse for federal income tax purposes. However, the laws of California recognize the right of husband and wife, by contract, to alter their respective property rights, changing separate property into community property or community property into separate property.

This Court has consistently held that where married persons, domiciled in a community property state, make an agreement, valid under state law, whereby the future earnings of either is converted into his or her separate property such agreements will be given effect in the administration of the federal income tax laws.

Under the agreement between this petitioner and his wife, when the agreement is considered as a whole, it is clear that the parties intended all future earnings of the petitioner to be his separate property. His

undertaking to pay his wife one-half of his "net income," as computed in accordance with the agreement, for the next two years after execution of the agreement does not require a construction of the agreement to the effect that the petitioner's earnings remained community property until the final decree of divorce was granted. In fact, such a construction would be contrary to the intention of the parties and the provisions of the agreement.

#### ARGUMENT

**The Board of Tax Appeals did not err in holding that the petitioner's personal earnings subsequent to execution of the property settlement with his wife are taxable entirely to him**

In this case the petitioner and Gertrude Martha Somerville had been married some years prior to September 1, 1936, and had resided together in California until sometime prior to that date (R. 15). On that date they entered into a property settlement agreement (R. 41-71), the material portions of which are set out in the foregoing statement. On September 28, 1936, Gertrude Martha Somerville obtained an interlocutory decree of divorce from the petitioner which was made final on October 2, 1937 (R. 15, 34, 37-40).

The only question involved in this proceeding is whether the petitioner's earnings for the period from September 1, 1936, to and including October 1, 1937, for personal services rendered by him was community property taxable one-half to him and one-half to his wife, or whether, by reason of the property-settlement

agreement, such personal earnings constituted separate property of the petitioner taxable entirely to him.

It is not denied that in the absence of any agreement of the spouses to the contrary the personal earnings of the petitioner for the period involved would have constituted community property under the laws of California and taxable one-half to each for federal income-tax purposes. *United States v. Malcolm*, 282 U. S. 792; Civil Code of California, Section 161a, *supra*. The Commissioner of Internal Revenue ruled, however, that the property-settlement agreement of September 1, 1936, had the effect of converting the petitioner's personal earnings subsequent to that date into his separate property (R. 6-11). His determination was sustained by the Board of Tax Appeals (R. 13-23). We submit the decision of the Board is right and should be affirmed.

The Civil Code of California (Sections 158 and 159) recognizes the right of married persons residing in California to make contracts with respect to their property. Under such contracts community property may be converted into the separate property of either spouse or the separate property of either may be converted into community property. See *Helvering v. Hickman*, 70 F. (2d) 985 (C. C. A. 9th), and cases cited. As this Court said in *Black v. Commissioner*, 114 F. (2d) 355, 358:

A consideration of the many cases bearing on this subject would serve merely to lengthen the opinion. This court has consistently upheld the proposition that where married persons, domiciled in a community property state, make

an agreement, valid under the local law, whereby the future earnings of each shall not become community property, but shall remain the separate property of the recipient, such agreement will be recognized in applying the federal income tax law. *Helvering v. Hickman*, 9 Cir., 70 F. 2d 985; *Van Every v. Commissioner*, 9 Cir. 108 F. 2d 650; *Sparkman v. Commissioner*, 9 Cir., 112 F. 2d 774.

See, also, *Woodall v. Commissioner*, 105 F. (2d) 474 (C. C. A. 9th), certiorari denied, 309 U. S. 655; *Boland v. Commissioner*, 118 F. (2d) 622 (C. C. A. 9th); *Marshall v. United States*, 26 F. Supp. 474 (C. Cls.), certiorari denied, 308 U. S. 597.

We do not understand the petitioner to question the above principles enunciated by this Court and the courts of California. His argument (Br. 6-27) is based upon the proposition that in the absence of an agreement to the contrary the earnings of the husband and wife are community property under the laws of California (Br. 6), which is not denied by the Commissioner; that the question for determination is whether under the property-settlement agreement the subsequent earnings of the petitioner became his separate property (Br. 7), with which the Commissioner agrees; and that the property-settlement agreement entered into with his wife did not convert his personal earnings into his separate property (Br. 9). With the latter contention the Commissioner does not agree.

The petitioner's argument that the property-settlement agreement did not convert his personal earnings thereafter into his separate property appears to be



based upon the proposition that "there is no provision in the agreement to the effect that the subsequent earnings of each spouse are to be the sole and separate property of the earner" (Br. 13).

Some of the cases particularly relied upon by the petitioner in support of this argument are cases decided by the California courts in which the widow, after the death of her husband, sought a family allowance during the period of the administration of his estate (Br. 20-26). In each of those cases the spouses had entered into a property-settlement agreement prior to the death of the husband, and the allowance was contested by the estate on the ground that the wife had waived it under the terms of the property-settlement agreement. But those cases are different from the instant case in important respects. In the first place, those cases, like the instant case, depended upon the interpretation of the property settlement involved. But of far greater importance is the fact that the question involved was whether the widow had waived her family allowance, and that depended upon a construction of the property-settlement agreement. No such question is involved here.

In this connection, however, it is to be noted that if the same question were at issue in the instant case a court might well reach a contrary conclusion because, in addition to the initial inducement clause stating the reason for the agreement and the intention of the parties executing it (R. 41-42), it is expressly provided that the arrangement for the payment of one-half of petitioner's net income to his wife for two

years should be in full and final settlement of any and all claims of either against the other, other than as otherwise disposed of in the agreement, "whether in law or in equity or in *probate*"; also in full settlement of "any and all claim or claims of community property which either might or could make against the other"; and, finally, in full and final settlement of any and all future claims which either might assert against the other, "of whatsoever kind or nature, whether in law and/or in equity and/or in *probate*" (R. 49-50). [Italics supplied.] Furthermore, by Article XIV of the agreement (R. 67), the petitioner's wife expressly waived and released any claim for attorney's fees or costs in connection with any claim or claims, "either in law, equity or probate," whether valid or invalid, against the petitioner, and whether arising or made prior or subsequent to the agreement or arising out of the signing of the agreement.

We submit that, were the question whether the petitioner's wife had waived her right to a family allowance involved here, which it is not, it could justifiably be concluded, from the terms of the agreement as a whole, including the above provisions, that the wife had waived any right to a family allowance. Compare *In re Davis*, 106 Cal. 453.

The decisions in *Biggi v. Biggi*, 98 Cal. 35, and *Estate of Hurley*, 28 Cal. App. (2d) 584, cited by petitioner (Br. 15, 17), are equally inapplicable here. The former decision dealt with disposition of a parcel of real estate covered by a general property settlement, while the latter dealt with the surviving husband's rights in the estate of his deceased wife under

a property-settlement agreement, which was in no way comparable with the agreement executed by this petitioner and his wife.

While the decisions of this Court cited above are determinative of the questions of law here involved, it still remains to be determined whether the property-settlement agreement involved in this case had the effect of converting the petitioner's personal earnings into his separate property. We submit that when the agreement is considered as a whole, as it must be, in the light of the expressed intentions of the parties and the purpose which they accomplished, there can be no basis for concluding that the petitioner's personal earnings remained community property after execution of the agreement.

The property settlement itself (R. 41-71) is too long and wordy to justify a full analysis here. But the purpose of entering into the agreement (R. 41-42), and the results accomplished are clear. The parties had come to the end of their marital career and already were living apart without any prospect of reconciliation. They intended, and by the agreement accomplished, a complete division of all property owned by them, a settlement of all rights and claims which either might assert, and assured the continued support and custody of their minor child.

While the agreement must be construed as a whole to arrive at a correct solution of this appeal, the income involved is one-half of the amount which the petitioner treated in his income tax returns as community income for the period from September 1, 1936, through October 1, 1937, although not necessarily that

part of the petitioner's "net income," computed in accordance with the agreement (R. 44-49), which was payable to the petitioner's wife for the period prior to entry of the final divorce decree. The petitioner contends that such income from personal services was community property under the laws of California until entry of the final divorce decree on October 2, 1937, but makes no such contention with respect to such income, a part of which had to be paid to his wife during the balance of the two-year period following the execution of the property-settlement agreement.

In this respect the instant case does not differ materially from *Boland v. Commissioner*, 118 F. (2d) 622 (C. C. A. 9th), and *Woodall v. Commissioner*, 105 F. (2d) 474 (C. C. A. 9th). In each case the spouses entered into a property-settlement agreement similar to the one here involved. In the *Boland* case the agreement provided for payment of a percentage of the taxpayer's personal earnings to his wife for life or until she remarry, whether divorced or not, while in the *Woodall* case the taxpayer's husband received substantially one-half her earnings under their understanding of the agreement until they were finally divorced. On authority of those two decisions, and other decisions of this Court cited above, it must be concluded that this petitioner's personal earnings subsequent to execution of the property-settlement agreement with his wife were his separate property and taxable entirely to him.

## CONCLUSION

The decision of the Board of Tax Appeals is right. It is fully supported by the facts and the law and should be affirmed.

Respectfully submitted.

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SEPTEMBER 1941.

